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# In the Supreme Court of the United States

OCTOBER TERM, 1932

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No. —

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE for the Third District of New York, petitioner

*v.*

MARIAN STEEDMAN WILSON, ROBERT GOELET, AND Harlem G. Rubert, as Executors of the Estate of Richard T. Wilson, deceased

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF**

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**PETITION**

The Solicitor General, on behalf of the Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit, entered in the above cause on July 18, 1932, affirming in part and reversing in part the decision of the District Court for the Southern District of New York.

## QUESTION PRESENTED

Under the terms of a trust created by will, a beneficiary was entitled to receive one-fifth of the annual income of the trust and one-fifth of any distributions of corpus which the trustees might make in the exercise of the discretion given them by the will. Real estate constituting a part of the corpus of the trust was sold at a loss in 1922. The question is whether any part of the loss sustained by the trust on the sale may be deducted in the individual return of the beneficiary.

## STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations will be found in the Appendix, *infra*, pp. 18–25.

## STATEMENT

This suit was instituted by Richard T. Wilson, Jr., a resident of the State of New York, to recover income taxes paid for 1922. He died while the litigation was pending and his executors were substituted as parties plaintiff. (R. 60.)

The District Court made special findings of fact (R. 59–79), based on certain stipulations of fact (R. 27–58) from which the following appears:

Richard T. Wilson, Sr., also a resident of the State of New York, died on November 26, 1910, the owner of real estate in that State of the value of $2,216,083.33 and a large amount of other property. Included in the real estate was an office building located at 384–6 Broadway, New York,

N. Y., known as the "Commercial Building." (R. 60, 72–73. His will was admitted to probate in New York County on December 13, 1910. (R. 60.)

The second article of the will gave his wife a life interest in a fund of $250,000. (R. 61.) The third article of the will (R. 61–62) directed the executors to set apart out of his estate five separate funds of $500,000 each to be given in trust to the Union Trust Company of New York to invest and reinvest the same and collect the net income therefrom and to pay over the net income of the funds to his two sons and three daughters, respectively, including Richard T. Wilson, Jr. At the death of any child, the principal of the fund was to pass to his lineal descendants then living, and in default of such lineal descendants, to his or her brothers and sisters then living or their lineal descendants, *per stirpes* and not *per capita*.

The fourth article of the will (R. 62–63) directed that the executors convert all of the rest of the testator's estate, whether real or personal, into personalty and to divide the proceeds into five equal parts. Two of these parts he gave to a son and a daughter absolutely. One part to the amount of $500,000 he directed to be added to the trust fund created for the benefit of Richard T. Wilson, Jr., subject to all the provisions of that trust, and the balance of such part to be his absolutely. Two other parts were similarly dealt with for the benefit of two of his daughters.

The fifth article (R. 63–68) directed his executors to first constitute the funds mentioned in the second and third articles, and then to constitute the additions to the trust funds for the benefit of Richard T. Wilson, Jr., and his two daughters which were provided for in the fourth article. Both the trusts and the additions thereto were to be constituted out of securities belonging to the estate at their market value or the proceeds thereof (other than shares of any manufacturing or business corporation) or securities purchased at their cost. This article further provided (R. 65):

> As the balance of my residuary estate will largely consist of real estate in this and other States and shares of manufacturing and business corporations which should not be sold excepting under favorable conditions, I direct my said executors to hold and manage such remaining portion of my residuary estate until in their judgment it can from time to time be advantageously sold and disposed of, not exceeding however a period longer than the lives of my sons Marshall Orme Wilson and Richard T. Wilson, Jr., and the survivor of them, and I hereby authorize and empower my said executors within said period, to sell, convey, assign and transfer the same, or any part thereof, at such time or times as they may deem for the best interests of my estate, and upon such terms and conditions as they may deem proper, including the terms and mode of payment therefor.

The executors were also authorized in their discretion to organize a corporation, to convey to it in return for its capital stock the whole or any part of the residuary estate, and to hold the stock until it could be disposed of advantageously. No such corporation was organized. They were further authorized upon the sale of any part of the residuary estate to distribute the proceeds forthwith or in their discretion to retain the same for further conversion before distribution. Prior to distribution the net income of the residuary estate or of the corporate shares was to be paid semiannually to the persons entitled to receive it under the fourth article. (R. 65–67.)

The trusts provided for in the will were set up out of personal property of the estate in 1911 and 1912. Prior to the year 1922 all of the debts of the decedent and of the estate except current expenses had been paid and almost all of the assets not used in setting up these trusts had been distributed. (R. 73, 75–76.)

The Commercial Building was not sold until 1922, when it was disposed of for $165,000. The sale involved a loss of $113,300, based upon the value of the building at the date of the testator's death. During 1922 the trustees distributed $50,000 to the so-called residuary legatees, but the record fails to disclose what, if any, portion of this amount was derived from the sale of the Commercial Building. (R. 75, 76.)

Richard T. Wilson deducted $22,660 or one-fifth of this loss in his return for 1922. (R. 78.)

The District Court and the Circuit Court of Appeals both held that the will of the testator created a residuary trust and that the Commercial Building constituted a part of the corpus of the trust. (R. 97, 110.)

The District Court allowed the total deduction claimed by Richard T. Wilson, Jr. The Circuit Court of Appeals held that to the extent that there was a distribution to the beneficiary of any part of the proceeds of the sale he suffered a proportionate part of the loss. Since the record failed to disclose what portion of the $50,000 distributed to the five so-called residuary legatees represented such proceeds, it held that if all of the distribution represented such proceeds the loss would be $\frac{50000}{165000}$ of $113,300, or $6,866.66 divided by five, and remanded the case for further proceedings.

## SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that any part of the loss sustained by the Richard T. Wilson, Sr., Trust, upon the sale of real property constituting a part of the trust, was deductible in the return of the beneficiary, Richard T. Wilson, Jr.

2. In failing to hold that there is no statutory authority in the Revenue Act of 1921 for the deduction by a beneficiary of a trust of losses incurred

on the sale of trust assets, irrespective of whether the beneficiary may or may not receive distributions of corpus as well as of income.

REASONS FOR GRANTING THE WRIT

1. In so far as the court below held that any part of a loss sustained by a trust estate upon the sale of assets constituting a part of the corpus is deductible by a beneficiary, we believe that the decision conflicts in principle with *Abell* v. *Tait,* 30 F. (2d) 54 (C. C. A. 4th), certiorari denied, 279 U. S. 849, and *Baltzell* v. *Mitchell,* 3 F. (2d) 428 (C. C. A. 1st), certiorari denied, 268 U. S. 690, where it was determined that there was no statutory authority for the allowance of such losses to beneficiaries under Section 219 of the Revenue Acts of 1918 and 1921, *infra,* pp. 19–21. In the cases cited the beneficiaries received current distributions of income but were not entitled to receive any distributions of corpus at any time, whereas in the case at bar the beneficiary might receive such distributions of corpus as the trustee might make in the exercise of the discretion given to him in the will.

But Section 219 of the Revenue Act of 1921, *infra,* which provides for the taxation of income from trusts, does not distinguish between beneficiaries on that basis and does not provide for the allowance of losses to them whether they are entitled to distribution of corpus or not.

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We do not believe that the case of *Merle-Smith* v. *Commissioner,* 42 F. (2d) 837 (C. C. A. 2d), certiorari denied, 282 U. S. 897, furnishes a determinative rule. It was there held that a deduction for depletion should be allowed to a beneficiary who was entitled to 75 per cent of the income of the trust and would soon receive part of the corpus (at the age of forty-five) with power to dispose thereof by will at any time before. The depletion provision merely authorizes reasonable allowance for depletion without providing to whom it shall be allowed. On the other hand, losses to be deductible under Section 214 must be sustained in trade or business or in a transaction entered into for profit.

2. We believe that the decision below disregards the familiar principle stated in *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301, and other cases that no deductions may be allowed unless specific authority therefor is found in the statute.

3. The question is one of general importance which will arise under all of the Revenue Acts to the present time. The Treasury Department has consistently treated a trust and the beneficiaries thereunder as separate taxable entities (except as such practice was limited by decisions similar to that in the *Merle-Smith* case, *supra*). This case not only overturns that principle but leaves entirely uncertain the limits of the application of its rule that one may secure the benefit of a deduction which by statute is allowable only to another. An

authoritative decision is needed for the guidance of the Treasury Department in its administration of the law.

Wherefore, it is respectfully submitted that this petition should be granted.

THOMAS D. THACHER,
*Solicitor General.*

OCTOBER, 1932.

## BRIEF IN SUPPORT OF PETITION

### OPINIONS BELOW

The opinion of the District Court for the Southern District of New York (R. 91–99) is reported in 51 F. (2d) 268. The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 60 F. (2d) 52.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 18, 1932. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

### QUESTION PRESENTED, STATUTES AND REGULATIONS INVOLVED, ETC.

A statement of the question presented, statutes and regulations involved, specification of errors to be urged, and a statement of the case will be found in the foregoing petition.

### ARGUMENT

The court below correctly construed the will of Richard T. Wilson, Sr., as creating trusts in all of his undistributed residuary estate and correctly held that the trust for Richard T. Wilson, Jr., was

to continue irrespective of any sales so far as the executors (trustees) chose to hold rather than to distribute the proceeds, the executors (trustees) being authorized to hold the *res,* manage the property, sell and reinvest the proceeds and pay over the income of the trust annually during two lives in being.[1]

The question, then, is whether Richard T. Wilson, Jr., who received annual distributions of income under the trust and would receive distributions of corpus in so far as the trustees chose to make such distributions, is entitled in his individual return for 1922 to deduct a loss on the sale of property constituting a part of the corpus of the trust.

Under Section 219 of the Revenue Act of 1921, *infra,* pp. 19–21, trusts are classified according to the disposition to be made of the income and not according to the disposition to be made of the corpus, and the trust in this case falls under Section 219 (a) (4), for the reason that the income is to be distributed to the beneficiary periodically. Hence, under subdivision (d) no tax on the trust income is

[1] A will which directs the executors to convert real estate into personalty and in their discretion to withhold, convert, or distribute the proceeds and in the meanwhile to pay over the net income to designated beneficiaries, creates an express trust under Section 96 of the Real Property Law of New York, *infra,* pp. 24–25. See *Morse et al.* v. *Morse et al.,* 85 N. Y. 53; *Marx* v. *McGlynn, Ex'r, etc., et al.,* 88 N. Y. 357; *Ward* v. *Ward et al.,* 105 N. Y. 68; *Lahey* v. *Kortright,* 132 N. Y. 450.

to be paid by the fiduciary, but the beneficiary is required to report—

> that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, * * *.

Where the fiduciary receives income upon which he is taxed by Section 219, he of course may deduct losses sustained upon the sale of capital assets by virtue of the fact that Section 219 (b), *infra*, p. 19, provides that he shall be taxed as an individual and the fiduciary would be entitled to any deduction which an individual might take under Section 214 (a), *infra*, p. 18.

But there is no authorization in the statute for the deduction of such losses by the beneficiary when he and not the fiduciary is taxed. Section 219 does not provide that the trust income to be reported by him in his return, that is, the share of the trust income which is distributable to him under the terms of the will or deed, shall be reduced by capital losses sustained by the trust. If Congress had intended that it should be so reduced under such circumstances, it would probably have said so, for it expressly provided that a beneficiary of a trust coming under Section 219 (a) (4) should receive a proportionate part of the personal exemption allowable to a trust. Section 219 (d), *infra*, p. 20.

Two Circuit Courts of Appeals have held that a beneficiary may not deduct any portion of a loss sustained on the sale of capital assets by a fiduciary.

The case of *Baltzell* v. *Mitchell,* 3 F. (2d) 428 (C. C. A. 1st), certiorari denied, 268 U. S. 690, arose under the Revenue Act of 1918, Section 219 of which was substantially the same as Section 219 of the Revenue Act of 1921, here involved. The court there held that a beneficiary was required to report the income distributable to her under the terms of the will and that she could not deduct from it any loss on the sale of capital assets by the trustee. The court said (pp. 430–431):

> It cannot be supposed that Congress intended that the taxes under sections 210 and 211 should be paid by an individual who was engaged in some business or gainful occupation which yielded an income upon which such tax could be levied and collected, and also provided that the beneficiary of a trust, although paid a large amount in accordance with the terms of such trust, should escape all taxation upon the amount so paid, because the trust, as such, through losses of capital, did not show a net income. The fiduciary and the beneficiary are separate taxable persons. *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, * * *, 15 A. L. R. 1305. The fiduciary is to pay the tax upon the net income of the estate or trust, and, in determining this net income, gains and losses of capital are to be considered.

The court further held that the beneficiary could not claim a loss in computing net income on her individual return, for the loss was not sustained in

trade or business or in a transaction entered into for profit within the meaning of Section 214 (a) (4) and (5), *infra*. Cf. *Kenan* v. *Bowers*, 50 F. (2d) 112 (C. C. A. 2d), and *Busch* v. *Commissioner*, 50 F. (2d) 800 (C. C. A. 5th), where it was recognized that the business and transactions of the trust are not the business and transactions of the beneficiary.

The same conclusion was reached in *Abell* v. *Tait*, 30 F. (2d) 54 (C. C. A. 4th), certiorari denied, 279 U. S. 849. In that case also the court recognized that the trust and the beneficiary were separate taxable entities and that the beneficiary could not deduct a loss which under the law was only allowable to the trust.

The Treasury Department has consistently taken the same view, following O. D. 156, C. B. 1 (1919), p. 181, which has never been revoked.

The same principle has been applied in a number of cases holding that a beneficiary may not deduct depreciation of the trust assets.[2] *Mary Roxburghe*, 64 C. Cls. 223, certiorari denied, 278 U. S. 598; *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App. D. C.); *Codman* v. *Miles*, 28 F. (2d) 823 (C. C. A. 4th), certiorari denied, 278 U. S. 654; *Hubbell* v. *Burnet*, 46 F. (2d) 446 (C. C. A. 8th), certiorari

[2] The beneficiary, of course, may get the benefit of a deduction for depreciation in the event that the will provides that he shall receive only the income which remains after the allowance of depreciation. *Hubbell* v. *Burnet*, *infra*.

denied, 283 U. S. 840; *Codman* v. *Commissioner,* 50 F. (2d) 763 (C. C. A. 1st); *Roxburghe* v. *Burnet,* 58 F. (2d) 693, certiorari denied, 286 U. S. 567. See also *Kaufmann* v. *Commissioner,* 44 F. (2d) 144 (C. C. A. 3d).

While in the cases cited, with the exception of the *Kaufmann* case, it did not appear that the particular beneficiary would be entitled at any time to receive distributions of corpus, the courts have not based their decisions solely upon the fact that the beneficiary had no interest in the corpus, but have also relied upon the fact that the beneficiary and the trust are separate taxable entities and that the statute does not provide for the deduction of capital losses and depreciation in determining the distributive shares of beneficiaries. See *Baltzell* v. *Mitchell, supra; Hubbell* v. *Burnet, supra; Whitcomb* v. *Blair, supra.*

In the *Kaufmann* case, *supra,* it was held that a widow to whom the testator gave income from property for life with privilege of invading the corpus was not entitled to depreciation.

We do not believe that the case of *Merle-Smith* v. *Commissioner,* 42 F. (2d) 837 (C. C. A. 2d), certiorari denied, 282 U. S. 897 harmonizes this case with the cases of *Abell* v. *Tait, supra,* and *Baltzell* v. *Mitchell, supra.* In that case it was held that a beneficiary entitled to royalties from mining properties held in trust with a remainder interest in the corpus, shortly to become vested, was taxable only

upon the excess of the royalties received over the depletion sustained. The decision there appears to have been based partly upon the theory that the beneficiary had a real interest in the corpus of the trust and partly upon the peculiar nature of depletion. See *Weiss* v. *Wiener*, 279 U. S. 333. The statute allowing depletion merely provides for a deduction of a reasonable allowance for depletion and provides for the equitable apportionment of depletion between lessors and lessees. The loss provisions are not so broad and leave no room for equitable considerations. They permit the deduction only of specific losses.

Deductions may be claimed only to the extent that they are authorized by statute. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301; *Lynch, Executrix,* v. *Alworth-Stephens Co.*, 267 U. S. 364; *Goldfield Consolidated Mines Co.* v. *Scott*, 247 U. S. 126; *Darby-Lynde Co.* v. *Commissioner*, 51 F. (2d) 32 (C. C. A. 10th). Since the beneficiary in this case can not point to any provision in the statute which authorizes the deduction claimed, we submit that it is not allowable.

The court below allowed only a part of the loss, holding that the amount allowable depended upon the proceeds of the sale distributed during the taxable year. We believe that a discussion of the merits of a deduction on that basis has no place in this petition, for our position is that no portion of the loss is deductible.

## CONCLUSION

We submit that the decision of the Circuit Court of Appeals was erroneous, and that, in view of the general importance of the question decided and the existence of a conflict in principle between that decision and decisions of other Circuit Courts of Appeals, the petition for certiorari should be granted.

Respectfully submitted.

THOMAS D. THACHER,
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OCTOBER, 1932.

# APPENDIX

REVENUE ACT OF 1921, C. 136, 42 STAT. 227, 239, 246

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of this Act where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed;

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each bene-

ficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a), or in any other case within subdivision (a) of this section, except paragraph (4) thereof, the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed

to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(c) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable during the taxable year to such beneficiary. Section 219 of the Revenue Act of 1918, 40 Stat. 1057, 1071, contained similar provisions with the exception of subdivision (e).

TREASURY REGULATIONS 62

ART. 341. *Estates and trusts.*—While certain estates and trusts are subject to tax as such and others are not, the fiduciary in every case is required to make a return of income. See section 225 of the

statute and articles 421–425. The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that in place of the deduction allowed individuals of certain gifts or contributions there may be deducted, without limitation, from the gross income any part of it which during the taxable year is pursuant to the will or trust deed paid or permanently set aside in the manner specified in section 214 (a) (11). See section 212 and articles 21–26.

ART. 342. *Estates and trusts taxed to fiduciary.*— In the case of (a) estates of decedents before final settlement, (b) trusts, whether created by will or deed, for accumulation of income, whether for unascertained persons or persons with contingent interests or otherwise, and in any other case within section 219 (a) except paragraph 4 thereof, the income is taxed to the fiduciary as to any single individual, except that from the income of a decedent's estate there may first be deducted any amount of income properly paid or credited to a beneficiary. See section 200 of the statute and articles 1521 and 1522. Where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee irrespective of the exercise of the discretion. The imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person exempt from tax. An allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon a sale by the heirs, whether before or after settle-

ment of the estate, each heir is taxed individually on any profit derived.

ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income, or may be capital gain, taxable to the estate. See articles 1562 and 1563.

ART. 345. *Estates and trusts taxed to beneficiaries.*—In the case of (a) a trust the income of which is distributable periodically, (b) an ordinary guardianship of a minor, and (c) an estate of a decedent before final settlement as to any income properly paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each such beneficiary must include

in his return his distributive share of the net income, even though not yet paid him, but if his taxable year is different from that of the estate or trust, then he need only include in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within his taxable year. The regulations governing partnerships are generally applicable to such an estate or trust. See articles 331–335.

ART. 347. *Estates and trusts with income which is distributed periodically, and other income.*—In the case of an estate or trust, the income of which consists both of income to be distributed to beneficiaries periodically and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with section 219 (b) and the tax shall be imposed and paid by the fiduciary in accordance with section 219 (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in section 219 (a) (4) which, pursuant to the will or trust deed, is distributable during its taxable year to the beneficiaries. Each of such beneficiaries shall include, in computing his net income, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to him during the taxable year.

## McKINNEY'S CONSOLIDATED LAWS OF NEW YORK, ANNOTATED, BOOK 49, REAL PROPERTY LAW

SEC. 96. *Purposes for which express trusts may be created.*—An express trust may be created for one or more of the following purposes:

1. To sell real property for the benefit of creditors;

2. To sell, mortgage, or lease real property for the benefit of annuitants or other legatees, or for the purpose of satisfying any charge thereon;

3. To receive the rents and profits of real property, and apply them to the use of any person, during the life of that person, or for any shorter term, subject to the provisions of law relating thereto;

4. To receive the rents and profits of real property, and to accumulate the same for the purposes, and within the limits, prescribed by law.

SEC. 97. *Certain devises to be deemed powers.*—A devise of real property to an executor or other trustee, for the purpose of sale or mortgage, where the trustee is not also empowered to receive the rents and profits, shall not vest any estate in him; but the trust shall be valid as a power, and the real property shall descend to the heirs, or pass to the devisees of the testator, subject to the execution of the power.

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Marian Stebbins Wilson, Robert Goelet, and Harlem G. Rubert, as Executors of the Estate of Richard T. Wilson, Jr., Deceased,

*Petitioners,*

v.

Charles W. Anderson, Collector of Internal Revenue for the Third District of New York,

*Respondent.*

*ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

BRIEF FOR THE COLLECTOR

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# In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 460

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE for the Third District of New York, petitioner

*v.*

MARIAN STEEDMAN WILSON, ROBERT GOELET, AND Harlem G. Rubert, as executors of the estate of Richard T. Wilson, jr., deceased

No. 461

MARIAN STEEDMAN WILSON, ROBERT GOELET, AND Harlem G. Rubert, as executors of the estate of Richard T. Wilson, jr., deceased, petitioners

*v.*

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE for the Third District of New York

*ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE COLLECTOR

### OPINIONS BELOW

The opinion of the District Court (R. 40–45) is reported in 51 F. (2d) 268. The opinion of the

Circuit Court of Appeals (R. 48–53) is reported in 60 F. (2d) 52.

**JURISDICTION**

The judgment of the Circuit Court of Appeals was entered July 18, 1932. (R. 53.) Petitions for writs of certiorari were filed by both parties on October 18, 1932, and were granted November 21, 1932. (R. 54.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

**QUESTIONS PRESENTED**

No. 460

1. Whether any part of the loss sustained on a sale of trust assets by a testamentary trustee may be deducted in the individual return of a beneficiary of the trust.

No. 461

2. Whether the interest of the taxpayer in a building included in the residuary estate of his father was that of a residuary legatee or that of a beneficiary of a trust.

3. If it is decided in No. 460 that the beneficiary is entitled to a deduction, whether that deduction should be limited to the proportion of the proceeds from the sale actually distributed to the beneficiary during the taxable year.

**STATUTES AND REGULATIONS INVOLVED**

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 35–43.

**STATEMENT**

This suit was commenced by Richard T. Wilson, Jr., a resident of New York, to recover income taxes paid for 1922. He died while the litigation was pending and his executors were substituted as parties plaintiff. (R. 1, 12, 26–27.) The District Court made special findings of fact (R. 27–36), based on a stipulation (R. 12–26), from which the following appears:

Richard T. Wilson, Sr., died on November 26, 1910, the owner of real estate in New York of the value of $2,216,083.33 and a large amount of other property. (R. 28, 33.) Included in the real estate was an office building in New York City, known as the "Commercial Building" which he had acquired at a cost of $210,000. (R. 33, 35.) His will was admitted to probate in New York County on December 13, 1910. (R. 28.)

The will directed the executors to establish five separate trust funds of $500,000 each for the benefit of the decedent's two sons and three daughters, including Richard T. Wilson, Jr., with remainders to their respective children. (R. 28.) The fourth article of the will (R. 28–29) directed the executors to convert all the rest of the testator's estate into personal property and to divide the proceeds into five equal parts. Two of these parts he gave to a son and a daughter absolutely. One part to the amount of $500,000 he directed to be added to the trust fund created for the benefit of Richard

T. Wilson, Jr., subject to all the provisions of that trust, and the balance of this part was to be his absolutely. Two other parts were similarly dealt with for the benefit of two of his daughters.

The fifth article of the will (R. 29–31) directed that the executors should first establish the funds already referred to out of securities belonging to the estate. This article then provided (R. 30):

> As the balance of my residuary estate will largely consist of real estate in this and other States and shares of manufacturing and business corporations which should not be sold excepting under favorable conditions, I direct my said executors to hold and manage such remaining portion of my residuary estate until, in their judgment, it can from time to time be advantageously sold and disposed of, not exceeding however a period longer than the lives of my sons Marshall Orme Wilson and Richard T. Wilson, jr., and the survivor of them, and I hereby authorize and empower my said executors within said period, to sell, convey, assign and transfer the same, or any part thereof, at such time or times as they may deem for the best interests of my estate, and upon such terms and conditions as they may deem proper, including the terms and mode of payment therefor.

The executors were also authorized in their discretion to organize a corporation, to convey to it in return for its capital stock the whole or any part of the residuary estate, and to hold the stock until

it could be disposed of advantageously. (R. 30.) No such corporation was organized. (R. 35.) They were further authorized upon the sale of any part of the residuary estate to distribute the proceeds forthwith or in their discretion to retain the same for further conversion before distribution. (R. 30–31.) Prior to distribution the net income of the residuary estate or of the corporate shares was to be paid semiannually to the persons entitled to receive it. (R. 31.) Distribution of the principal could not be deferred beyond the period of the lives of the two sons. (R. 30–31.)

The trusts provided for in the will were set up out of personal property in the estate in 1911 and 1912. Prior to the year 1922 all of the debts of the decedent and of the estate except current expenses had been paid and almost all of the assets not used in setting up these trusts had been distributed. (R. 34–35.)

In 1922 the executors sold the Commercial Building for $165,000. Allowing for depreciation, the loss sustained on this sale was $113,300. The loss shown on the return for the estate was $125,005.84, of which the decedent deducted one-fifth, or $25,001.17 in his return. It was subsequently agreed that one-fifth of the loss sustained was actually $22,660. (R. 15, 35.)

The Commissioner disallowed the loss claimed by the decedent and assessed an additional tax. A claim for refund was filed and rejected, and this

suit was brought to recover the amount paid, with interest. (R. 36.) The District Court held that the will of Richard T. Wilson, Sr., created a residuary trust, but allowed the taxpayer to deduct the entire loss which he claimed, that is, $22,660. (R. 44–45.) The Collector appealed. The Circuit Court of Appeals likewise held that the will created a residuary trust, but held that the decedent should be allowed a loss only to the extent that there was a distribution to him of part of the proceeds of the sale. (R. 53.)

## SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that any part of the loss sustained by the Richard T. Wilson, Sr., Trust upon the sale of real property constituting part of the trust was deductible in the return of the beneficiary, Richard T. Wilson, Jr.

2. In failing to hold that there is no statutory authority in the Revenue Act of 1921 for the deduction by a beneficiary of a trust of losses incurred on the sale of trust assets, irrespective of whether the beneficiary may or may not receive distribution of corpus as well as of income.

## SUMMARY OF ARGUMENT

### I

The beneficiary of a trust is not entitled to a deduction on account of a capital loss sustained by a

sale of trust property. Section 214 of the Revenue Act of 1921 contains no provision authorizing the deduction claimed by the taxpayer. Here, the beneficiary was never vested with any title or interest in the building. He had no right to the possession of the trust property, and no right to control its management or disposition. No part of *his* capital was invested by *him* in any transaction entered into for profit. Therefore, the words "incurred in any transaction entered into for profit" in Section 214 (a) (5) should not be so broadly construed as to cover the present situation.

In several cases it has been held that a beneficiary whose interest is not limited in point of time may not deduct his share of the "operating loss" of the trust, that is, the excess of the deductions allowable to the trust over the income it has received. These cases seem to be direct authority for our position. Our contentions are also supported by other cases, although many of them involve life tenant beneficiaries rather than beneficiaries of the full beneficial interest. In several cases it has been held that the life beneficiary of a trust is not entitled to take a deduction on account of a loss sustained on the sale of capital assets by the trustee. In other cases the life beneficiary of a trust has been denied a deduction for depreciation of the trust property.

It has been the uniform practice of the Treasury Department since 1919 not to allow the beneficiary

of a trust a deduction on account of a capital loss sustained by the trustee. This construction has been uniform and long continued, and we submit it should be followed by this Court.

Section 219 of the Revenue Act of 1921 indicates the purpose of Congress to regard a trust for tax purposes as a distinct entity from the beneficiaries of the trust. The trust in this case is one in which all of the trust income is distributable to the beneficiaries, and Section 219 (d) provides that in such a case "the tax shall not be paid by the fiduciary," but that in computing the net income of each beneficiary there shall be included his distributable share of the income of the trust. There is consequently no authority in Section 219 for permitting the beneficiary to report only the net amount, or to reduce the amount which he receives by a loss on a sale by the trustee of capital assets.

If Congress had intended that the distributive share of a beneficiary should be reduced by capital losses sustained by the trust, it seems reasonable to suppose that it would have said so. If the property in question had been sold at a gain instead of a loss, the gain would have been taxable to the trust, whether the trustees had exercised their discretion to distribute it to the beneficiaries within the taxable year or not. The trust could have deducted the present loss from such a gain in reporting its income. But the fact that the trust may have no income taxable to it against which the deduction may be offset is not material. An excess of deductions

over taxable income is frequently encountered in the practical administration of the tax statutes.

The courts generally have taken the view that a trust is made a separate taxable entity under Section 219, and that a beneficiary may not claim a loss sustained by the trust on the sale of capital assets. Section 219 does not classify trusts on the basis of the extent of the interests of the beneficiaries. Its classification is based on the disposition to be made of the trust income and not on the identity of the person who is ultimately entitled to the corpus. Section 219 as a whole indicates that the beneficiary and the trust are to be regarded as separate entities for tax purposes.

## II

The executors of Richard T. Wilson, Jr., contend that his interest in the will of his father was that of a legal owner in fee, subject only to a power of sale in his father's executors, and that as a legal owner of a one-fifth interest in the building he was entitled to a deduction of one-fifth of the loss on its sale. Both courts below rejected this contention, and held that the interest of Richard T. Wilson, Jr., was that of a beneficiary of a trust of the residuary estate created by his father's will.

The conclusion that the will of Richard T. Wilson, Sr., created a trust of his residuary estate seems to us a necessary one. The will indicates plainly the purpose of the testator not to devise the

real estate as such to his children or to put it into their power to demand immediate distribution of the proceeds of the real estate. The broad powers given to the executors are consistent with the duties of trustees rather than executors. During the period of management the executors are directed to pay over the net income of the remaining residuary estate, a provision which is equivalent to an authorization to the executors to collect the rents of the real property and pay them over to designated beneficiaries. There is an unmistakable intention on the part of the testator to have the executors act as conservators and trustees, and to control and manage the estate for the benefit of the children.

The decisions in New York leave no room to doubt that the will of Richard T. Wilson, Sr., created a trust of his residuary real property, and that there is nothing in the New York statutes relating to trusts which requires a different conclusion. *Morse* v. *Morse,* 85 N. Y. 53, seems to us to be indistinguishable from the present case, and other New York decisions support the same conclusion.

## ARGUMENT

The question presented by the Government's petition for certiorari is whether a beneficiary of a testamentary trust is entitled to a deduction on account of a capital loss resulting from the sale of

part of the trust property. This question is discussed in Point I, below.

The representatives of the taxpayer have also filed a petition for certiorari in which they contend that the will in question did not establish a trust, but created legal interests subject only to powers in the executors. This contention, which was rejected by both courts below, is discussed in Point II, below.

## I

### THE BENEFICIARY OF A TRUST IS NOT ENTITLED TO A DEDUCTION ON ACCOUNT OF A CAPITAL LOSS SUSTAINED BY A SALE OF TRUST PROPERTY

#### *A. Section 214 of the Revenue Act of 1921 does not authorize the deduction claimed by the taxpayer*

The taxpayer in this case is claiming a deduction from admitted gross income. It is well settled that a taxpayer is not entitled to a deduction as a matter of right, and may have only such deductions as are specifically authorized by the statute. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103. We submit that there is no provision in the Revenue Act of 1921 which allows a deduction to a taxpayer on account of a capital loss sustained by a trust of which he is a beneficiary.

The deductions from gross income which are allowed to an individual taxpayer are contained in Section 214 of the Revenue Act of 1921 (*infra*,

p. 36). It is not necessary to enumerate all of these deductions here; they relate to business expenses, interest and taxes paid, losses, worthless debts, obsolescence, depletion, and contributions. The only paragraphs of this section which could conceivably be relied on by the taxpayer are paragraphs (4) and (5). Paragraph (4) allows the deduction of losses "incurred in trade or business." The executors of the taxpayer apparently make no contention that they are entitled to a deduction under this paragraph.

Paragraph (5) allows the deduction from gross income of—

> Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

We submit that there are two reasons why this paragraph of Section 214 is not applicable to the situation in this case. (1) It is difficult to see how it can be said that the loss was incurred in a transaction which the taxpayer entered into for profit; and (2) the statute obviously refers to losses sustained by the taxpayer who is claiming the deduction, and it does not follow that a loss sustained by a trust is sustained by a taxpayer who is a beneficiary of the trust.

The words "any transaction entered into for profit," used in Section 214 (a) (5), disclose only

a purpose to permit a taxpayer to make deductions of capital losses whenever *he* sells at a loss capital which *he* has invested in an effort to make a profit. They involve the requirement that property previously acquired by the taxpayer, either by purchase or by gift, has been devoted exclusively to the production of taxable income by him. Other paragraphs of Section 214 (a) have been interpreted to allow a taxpayer a deduction for payments which he made only if the obligation was in a strict sense the taxpayer's personal obligation. Thus in *Colston* v. *Burnet,* 59 F. (2d) 867 (App. D. C.), certiorari denied October 17, 1932, a taxpayer was denied a deduction on account of interest and taxes which he had paid on property the title to which stood in his wife's name. A similar result as to taxes was reached in *Falk Corp.* v. *Commissioner,* 60 F. (2d) 204 (C. C. A. 7th). For the same reasons, we contend that when the statute refers to a "transaction entered into for profit," it means a transaction entered into by the taxpayer who is claiming the deduction.

Here, the building which was sold, with a resulting loss, was never the taxpayer's property. In fact, the will expressly directed the executor to sell the building and convert it into cash; thus, the beneficiary from the beginning had no interest in the building, for his interest under the will was in equity converted into personal property. The beneficiary was never vested with any title or in-

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terest in the building. He had no right to the possession of the trust property, and no right to control its management or disposition. His only right was to a share of the proceeds from the sale of all the residuary estate; he cannot single out a specific piece of property not actually distributed to him for the purpose of claiming a capital loss deduction because of the sale of that property at a loss by the executors. No part of *his* capital was invested by *him* in any transaction entered into for profit. Cf. *Dalton* v. *Bowers* and *Burnet* v. *Clark,* Nos. 52 and 180, October Term, 1932, decided December 12, 1932.

The words "incurred in any transaction entered into for profit" should not be so broadly construed as to cover the present situation. In *Merriman* v. *Commissioner,* 55 F. (2d) 879 (C. C. A. 1st), it was held that they were not broad enough to allow a taxpayer to deduct expenses incurred in a suit to break the will of a relative, although the taxpayer undoubtedly would have realized a gain if she had succeeded in her effort. See also *Stephenson* v. *Commissioner,* 43 F. (2d) 348 (C. C. A. 8th); *Goldborough* v. *Burnet,* 46 F. (2d) 432 (C. C. A. 4th).[1]

[1] In *Kenan* v. *Bowers,* 50 F. (2d) 112 (C. C. A. 2d), the beneficiary sought to deduct as a business expense compensation paid by her to testamentary trustees in addition to that fixed by the will. The expense, although actually incurred by the beneficiary, was disallowed as a deduction, because it was not incurred in a transaction which she was carrying on as her business.

It is argued that since the statute fixes the basis for the computation of a loss on the sale of property acquired by gift, devise or descent, it must be assumed that Congress intended all losses arising from the sale of such property to be deducted. *Brewster* v. *Gage,* 280 U. S. 327, is relied upon as authority to that effect. But in *Brewster* v. *Gage,* the taxpayer was a residuary legatee and had for some time been in possession of the property and received income from it. Here, the taxpayer never acquired the building on account of whose sale he seeks to deduct a loss. He was only the beneficiary of a trust, whose trustees were directed to sell the building and convert it into cash. The beneficiary never had any right to the possession of the trust property nor any right to control its management, nor even to direct or prevent the sale upon which the loss is predicated.

Of the many cases relating to this question, the group with facts most nearly like those here involved support our contentions. These cases involve the claim of a beneficiary whose interest is not limited in point of time to deduct his share of the "operating loss" of the trust, that is, the excess of the deductions allowable to the trust over the income it has received. In several cases it has been held that the beneficiary is not entitled to take this deduction on his own return. *Busch* v. *Commissioner,* 50 F. (2d) 800 (C. C. A. 5th); *Appeal of Studebaker,* 2 B. T. A. 1020; *Haley* v. *Commis-*

*sioner,* 6 B. T. A. 782; *Balkwill* v. *Commissioner,* 25 B. T. A. 1147; see also *Little* v. *White,* 47 F. (2d) 512 (C. C. A. 1st). These cases seem to us to be direct authority for our position. In the *Busch case,* the court said (p. 802):

> It was plainly provided by the statutes that, for the purpose of accounting and determination of its income, a trust is a separate taxpaying entity, and it is perfectly clear that a beneficiary of a trust may not claim as his own a loss which the estate has sustained. This has been the uniform practice of the Commissioner, and the uniform holding of the Board of Tax Appeals * * *, and we think it not only accords with the meaning and intent of the statutes, but that the statutes permit no other disposition.[2]

Our position is also supported by several other cases, although many of them involve life tenant beneficiaries rather than beneficiaries with the full beneficial interest. In *Baltzell* v. *Mitchell,* 3 F. (2d) 428 (C. C. A. 1st), certiorari denied, 268 U. S. 690, and in *Abell* v. *Tait,* 30 F. (2d) 54 (C. C. A. 4th), certiorari denied, 279 U. S. 849, it was held that life beneficiaries of a trust, with a possible ultimate interest in the corpus, are not entitled to take a deduction on account of a loss sustained on the

[2] The opinion in the *Busch case* also contains (p. 802) a discussion of Articles 332 and 345 of Regulations 62, upon which the executors rely, and shows clearly why they are not applicable.

sale of capital assets by the trustee. The Board of Tax Appeals has consistently held that a beneficiary of a trust may not deduct a loss sustained by the trustee upon the sale of assets of the trust, without making any distinction as to the duration of the beneficiary's interest. *Appeal of Steffanson,* 1 B. T. A. 979; *Widener* v. *Commissioner,* 8 B. T. A. 651, affirmed on other grounds, 33 F. (2d) 833 (C. C. A. 3d); *Weil* v. *Commissioner,* 11 B. T. A. 415; *Stern* v. *Commissioner,* 14 B. T. A. 444. Likewise a residuary legatee has been denied the right to deduct a loss sustained by the executors during the period of administration of the estate. *Sevier* v. *Commissioner,* 14 B. T. A. 709. The Treasury Department in 1919 adopted the rule that the beneficiary of a trust is not entitled to deduct such a loss (O. D. 156, 1 C. B. 181), and has not departed from it.

The courts have uniformly held that a life tenant beneficiary of a trust is not entitled to a deduction for depreciation of the trust property unless the will or deed specifically provides that such deduction shall be made before ascertaining his distributive share; and then the deduction is not for depreciation, but because the beneficiary's distributive share is diminished. *Roxburghe* v. *United States,* 64 C. Cls. 223, certiorari denied, 278 U. S. 598; *Whitcomb* v. *Blair,* 25 F. (2d) 528 (App. D. C.); *Codman* v. *Miles,* 28 F. (2d) 823 (C. C. A. 4th), certiorari denied, 278 U. S. 654; *Hubbell* v. *Burnet,* 46

F. (2d) 446 (C. C. A. 8th), certiorari denied, 283 U. S. 840; *Codman* v. *Commissioner,* 50 F. (2d) 763 (C. C. A. 1st); *Roxburghe* v. *Burnet,* 58 F. (2d) 693 (App. D. C.), certiorari denied, 286 U. S. 567. See also *Kaufmann* v. *Commissioner,* 44 F. (2d) 144 (C. C. A. 3d).

It is true that in many of the cases cited above the beneficiary involved did not have the full beneficial interest. Although this, of course, makes the cases distinguishable in fact from the present case, we submit that the distinction is not significant. We believe that these cases must turn on the fact that the property in question was held in trust, rather than on the nature and extent of the beneficiary's interest. A legal life tenant is entitled to a deduction for depreciation (*Rose* v. *Grant,* 39 F. (2d) 338 (C. C. A. 5th), certiorari dismissed, 283 U. S. 867); if an equitable life tenant is not entitled to such a deduction, it must be because of the trust and not because of the duration of his interest.

We submit, therefore, that there is no provision in Section 214 of the Revenue Act of 1924 which authorizes the deduction claimed by the taxpayer in this case. As we have pointed out above, it has been the uniform practice of the Treasury Department since 1919 not to allow the beneficiary of a trust a deduction on account of a capital loss sustained by the trustee. This construction has been uniform and long continued. With it in effect,

Congress has five times reenacted the revenue law without making any change on this question.[3] In such circumstances the administrative construction is entitled to great weight and, we submit, should be followed by this Court.

*B. Section 219 of the Revenue Act of 1921 indicates the purpose of Congress to regard a trust for tax purposes as a distinct entity from the beneficiaries of the trust*

The Revenue Act of 1913 did not contain any specific provisions taxing a trust as a separate entity, and in *Smietanka* v. *First Trust & Savings Bank,* 257 U. S. 602, it was held that trust income which was accumulated for beneficiaries not in being was not taxable under that Act. In *Irwin* v. *Gavit,* 268 U. S. 161, under the same Act, it was held that income distributed to a beneficiary was taxable as income to him.

In the Revenue Act of 1916 there was incorporated Section 2 (b) (*infra,* pp. 35–36), an express provision dealing with the taxation of income received by estates and trusts. This section provided for the taxation of trust income in certain cases to the trust itself, to be paid by the trustee. With this provision Congress first classified trusts as separate

[3] In Section 23 of the Revenue Acts of 1928 and 1932 specific provision is made for the apportionment of allowances for depreciation and depletion between beneficiaries and trustees; these Acts contain no such provisions as to capital losses.

taxable entities, and this classification has been continued and developed in subsequent Revenue Acts.

The section which relates to the taxability of trusts in the Revenue Act of 1921 is Section 219 (*infra*, pp. 37–39). This section contains no express provision that a beneficiary of a trust shall be allowed a deduction for a loss sustained on the sale of trust property; nor do we think that there is any room in Section 219 to imply an intention on the part of Congress that such a deduction should be allowed.

Three general situations are recognized in Section 219, so far as trusts are concerned: (1) Trusts in which the income is being accumulated in trust for future distribution, (2) trusts in which all of the income is distributed periodically, and (3) trusts in which part of the income is to be distributed to the beneficiaries periodically and part is held for future distribution. In the first and third classes, the trust itself is taxed on all or a portion of the income, and deductions are allowed on its returns for losses sustained. These deductions are allowable on the trust's return because Section 219 (b) provides that the net income of the trust shall be computed in the same manner (with certain exceptions not here material) "as provided in section 212," which relates to the computation of the net income of individuals.

The trust in this case is one in which all of the current trust income is distributable to the bene-

ficiaries, and Section 219 (d) provides that in such a case "the tax shall not be paid by the fiduciary," but—

> there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, * * *.

It should be noted that the statute refers to "income," not "net income," and the beneficiary is required to report all income that is distributable to him under the trust, whether actually distributed or not. Where the trust instrument authorizes all income to be distributed to the beneficiaries without providing that capital losses shall be first deducted, there is consequently no authority in Section 219 for permitting the beneficiary to report only the net amount or to reduce the amount reported by a loss on a sale by the trustee of capital assets. The statute makes the beneficiary taxable on his distributive share, and on all of his distributive share, just as a stockholder is taxed on the full amount of the dividends which he receives, and may not deduct a loss which the corporation sustained. *Nixon* v. *Lucas*, 42 F. (2d) 833 (C. C. A. 2d).

If Congress had intended that the distributive share of a beneficiary should be reduced by capital losses sustained by the trust, it seems reasonable to suppose that it would have said so. Express pro-

vision was made in the statute for other deductions to be made by the beneficiary,[4] and the fact that Congress did not provide for the deduction by a beneficiary of capital losses indicates its intention not to allow such a deduction. *Expressio unius est exclusio alterius.* If the property in question had been sold at a gain instead of a loss, the gain would have been taxable to the trust, whether the trustees had exercised their discretion to distribute it to the beneficiaries within the taxable year or not. Cf. Regulations 62, Article 342 (*infra*, p. 41); *McCabe* v. *Commissioner*, 23 B. T. A. 1005. The trust could, of course, have deducted the present loss from such a gain in reporting its income. But the fact that the trust may have no income taxable to it against which the deduction may be offset is not material. An excess of deductions over taxable income is frequently encountered in the practical administration of the tax statutes. The same situation is present as to capital losses and deductions for depreciation when the income of a trust is distributable to a life tenant beneficiary, and in such a case all the authorities agree that the beneficiary is not entitled to the deduction merely because it avails the trust nothing. See the cases cited on pp. 15–18, *supra*.

[4] Thus, in Section 219 (d) it is provided that a beneficiary of a trust may deduct from his distributive share for normal tax purposes his proportionate part of the amount received by the trust as dividends, and for all purposes his distributive share of the tax-exempt interest. And in Section 204 (c) it is provided that the benefit of the deduction for net losses should be allowed to the beneficiaries of a trust.

The courts generally have taken the view that a trust is made a separate taxable entity under Section 219, and that a beneficiary may not claim a loss sustained by the trust on the sale of capital assets.[5] The decisions in *Baltzell* v. *Mitchell,* 3 F. (2d) 428 (C. C. A. 1st), certiorari denied, 268 U. S. 690, *supra,* and in *Abell* v. *Tait,* 30 F. (2d) 54 (C. C. A. 4th) certiorari denied, 279 U. S. 849, *supra,* were placed on this ground. In the *Baltzell case* the court said (p. 431): "The fiduciary and the beneficiary are separate taxable persons." In *Busch* v. *Commissioner,* 50 F. (2d) 800, 801 (C. C. A. 5th), *supra,* the court said "a trust is an entity entirely separate from its beneficiaries."

Section 219 does not classify trusts on the basis of the extent of the interests of the beneficiaries. Its classification is based on the disposition to be made of the income and not on the identity of the person who is ultimately entitled to the corpus. Section 219 expressly requires the trustee of a trust such as the one here involved to file a return showing the amount of income distributable to each beneficiary, and the beneficiary is taxed upon his distributive share, whether distributed or not. There is no indication that the beneficiary is to be relieved of this tax to the extent that he has received distributions of corpus, as well as of income, and the distributions in question are made from property sold at a loss. On the contrary, the re-

[5] Section 2 (9) of the Revenue Act of 1921 defines the word "taxpayer" as including a trust.

quirement that the beneficiary pay a tax upon his distributive share of income is made without restriction of any sort, and Section 219 as a whole indicates that the beneficiary and the trust are to be regarded as separate entities.

In this connection it should be remembered that the provisions of Section 219 were devised for the purpose of preventing the escape of trust income from taxation and that Congress may well have intended that beneficiaries should not receive any greater benefits than were naturally derived from the division of income which resulted from the creation of the trust with the consequent reduction of surtax.

The only decision in which the theory of the separate entity of the trust appears to have been ignored is the case of *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837 (C. C. A. 2d), certiorari denied, 282 U. S. 897. In that case it was held that a beneficiary entitled to royalties from mining properties held in trust, with a remainder interest in the corpus, shortly to become vested in possession, was taxable only upon the excess of the royalties received over the depletion sustained.[6] Even if the decision in the *Merle-Smith case* is correct, it does

[6] Since the denial of the petition for certiorari in that case the Commissioner and the Board of Tax Appeals have allowed deductions for depletion to the beneficiaries of trusts who have a remainder interest in the corpus. *Alphin* v. *Commissioner*, 21 B. T. A. 1101; *Kuhn* v. *Commissioner*, 24 B. T. A. 216; G. C. M. 9804, X–2 C. B. 353.

not follow that it should control the decision here. The result reached in that case was in part due to the court's recognition of the peculiar nature of depletion. See *Weiss* v. *Wiener,* 279 U. S. 333. The court emphasized the decision in *Lynch* v. *Alworth-Stephens Co.,* 267 U. S. 364, that depletion in the case of a mine is to be allowed to everyone whose property right and interest therein is diminished by extraction and disposition of the deposit. See also *Palmer* v. *Bender,* No. 215, October Term, 1932, decided January 9, 1933.

The District Court relied on *Munger* v. *Commissioner,* 16 B. T. A. 168, although the Circuit Court of Appeals held it inapplicable. We think the case is plainly distinguishable. The trust in question was of short duration, and the Board held that it was in fact only an agency, with the trustee having only the bare legal title. The same is true of several other Board decisions in which the beneficiary of a trust has been allowed a deduction.

*People ex rel. Field* v. *Gilchrist,* 240 N. Y. 301, arose under a New York tax statute, in construing which the court rejected the contention that a trust and one of its beneficiaries should be treated as separate entities, and allowed the beneficiary to deduct from his income the amount of taxes paid by the trustee on trust property. There the payment made by the trustee operated to reduce the beneficiary's income from the trust. Moreover, it was emphasized that the regulations of the State Tax Commission treated partnerships and estates

very much alike. Partnerships and trusts are treated alike to a limited extent under the Federal tax law, but they are not treated the same with respect to the deduction by a partner or beneficiary of a loss incurred in the operation of the partnership or trust. *Busch* v. *Commissioner,* 50 F. (2d) 800 (C. C. A. 5th), *supra.* In any event, the question here is plainly not affected by the construction of the New York statute.

We make no alternative argument to support the view of the court below that only a fractional part of the taxpayer's share of the loss should be deducted,[7] for we can see no authority in the statute for a deduction of any loss in this case. The statute authorizes the deduction by a taxpayer of "losses sustained," but, as we contend, Congress has not provided for the deduction of capital losses sustained by a trust from income of the beneficiary. This Court has declared that the courts may not grant a deduction which the law does not authorize. *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103, *supra.*

## II

### THE WILL OF RICHARD T. WILSON, SR., CREATED A TRUST OF HIS RESIDUARY ESTATE

The executors of Richard T. Wilson, Jr., contend that his interest under the will of his father was that of a legal owner in fee, subject only to a power of sale in his father's executors, and that as

[7] Compare the decision of the same court in *Martin* v. *Commissioner,* C. C. A. 2d, decided December 5, 1932.

a legal owner of a one-fifth interest in the building, he was entitled to a deduction of one-fifth of the loss on its sale. Both courts below rejected this contention, and held that the interest of Richard T. Wilson, Jr., was that of a beneficiary of a trust of the residuary estate created by his father's will.

The conclusion that the will of Richard T. Wilson, Sr., created a trust of his residuary estate stands upon at least three grounds. (1) The will indicates plainly the purpose of the testator not to devise the real estate as such to his children, or to put it into their power to demand immediate distribution of the proceeds of the real estate; the will indicates a purpose to distribute personal property to the children and to defer the sale and distribution as long as the executors deem it to be for the best interests of the children, subject only to limitations required by the rule against restraint on alienation. (2) The broad powers given to the executors are consistent with the duties of trustees rather than executors. (3) During the period of management, the executors are directed to pay over the net income of the remaining residuary estate—a provision which is equivalent to an authorization to the executors to collect the rents of the real property and pay them over to designated beneficiaries.

The will expressly provides that the residuary real estate shall not pass as such to the residuary legatees. The fourth article of the will contains a positive direction that the executors shall con-

vert all of the residuary estate into personalty. (R. 28.) In view of this mandatory direction to the executors to convert the real estate into personalty, it seems clear that the decedent did not become a residuary legatee with respect to any real estate.

After making dispositions of part of his residuary estate, the testator disposed of what might be termed the remaining residuary estate. He expressly recognized that this part of his estate would "largely consist of real estate * * * and shares of manufacturing and business corporations which should not be sold excepting under favorable conditions." (R. 30.) In view of this fact, he directed his executors "to hold and manage" this remaining portion of the residuary estate until in their judgment it could from time to time advantageously be sold. The executors were given complete discretion to sell the property as they might deem for the best interests of the estate. (R. 30.) They were given express authority to transfer the residuary estate to a holding corporation in exchange for its capital stock and to hold the stock until it could be disposed of advantageously. (R. 30.)

The will then authorized the disposition of the proceeds of any sale of the remaining residuary estate, if in the executors' judgment it might be distributed to the persons entitled "without any detriment to their interests," or in their discretion

to retain the proceeds, for further conversion, before distribution. (R. 30–31.) The executors were given the broadest powers in dealing with the property; they were authorized to vote stock constituting part of the remaining residuary estate, to consent to reorganizations of corporations, and "generally to have and exercise as to all such matters the powers of an individual owner who is under no trust obligation." (R. 31.) There is thus an unmistakable intention on the part of the testator to have the executors act as conservators and trustees and to control and manage the estate for the benefit of the children.[8]

The decisions in New York leave no room to doubt that the will of Richard T. Wilson, Sr., created a trust of his residuary real property, and that there is nothing in the New York statutes relating to trusts which requires a different conclusion. It is not essential to the creation of an express trust that the will specifically make a devise in trust to executors or trustees. *Morse* v. *Morse,* 85 N. Y.

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[8] In American Law Institute, Restatement of Trusts, Sec. 9, Comment *b*, the rule is stated as follows: "In the absence of a statute otherwise providing, the duties of an executor are: (1) To reduce to possession the personal assets of the testator; (2) to pay the testator's debts; (3) to pay legacies; and (4) to distribute the surplus, if any, among the testator's next of kin.

"If a testator names the same person as executor and as trustee, he is acting as executor in performing the four duties named above; but in performing additional duties he is acting as trustee. * * *"

53; *Marx* v. *McGlynn,* 88 N. Y. 357; *Brewster* v. *Striker,* 2 N. Y. 19. So long as the testator has clothed his executors with the power and duty of executing an express trust, it is immaterial that he has not called them trustees or termed their position a trust. *Close* v. *Farmers' Loan & Trust Co.,* 195 N. Y. 92; *Mee* v. *Gordon,* 187 N. Y. 400.

*Morse* v. *Morse,* 85 N. Y. 53, *supra,* seems to us to be indistinguishable from the present case. There, the testator, after making certain specific bequests, gave five-sixths of his residuary estate, both real and personal, to five of his children to be divided equally among them. In one of the final clauses of the will, the executor was authorized to sell and convey any and all of the real estate "at such time and in such manner as he shall think it proper for the interests of my estate," and to rent and lease the real property until sold. In holding that the will created a trust and not an outright devise subject to a power of sale, the court said (pp. 59–60):

> * * * The direction to sell was imperative, and operated in equity as a conversion of the land into money. * * * There is no express direction in the will as to the disposition to be made by the executor of the rents received. But the reasonable inference and implication is, that they are to go to the persons beneficially interested in the estate. (*Moncrief* v. *Ross,* 50 N. Y. 431.) Nor does the will expressly authorize the

executor to receive the rents and profits of the land until sale. But the power to rent and lease the land carries with it and includes the power to receive the rents accruing from its execution.

We are of opinion that the will created a valid express trust in the executors, under the Revised Statutes, to sell lands for the benefit of legatees, under the second subdivision of section 55, before cited, and that the children of the testator took no title or estate in the land. To constitute a valid express trust, it is not necessary that the purpose of the trust should be stated in the precise words of the statute. It is undoubtedly necessary to a valid trust under the statute, that the trust shall be declared in the will, or other instrument, by which it is created. But no particular formula of words, need be used. It is not essential that the words "trust" or "trustee" should be used, or that there should be a direct devise in terms to the trustee, or that the authority to receive the rents and profits, should be conferred in express language. It is sufficient if the intention to create a trust under the statute, can be fairly collected from the instrument, and what is implied from the language used, is, as in other instruments, deemed to be expressed. Nor will the instrument necessarily fail as a trust, because the authority given could be executed by the creation of a mere power in trust. The test is whether the instrument confers upon the trustee an

> authority in respect to the land, and the power is conferred to accomplish one of the purposes mentioned in the fifty-fifth section of the statute. (*Vernon* v. *Vernon*, 53 N. Y. 351, and cases cited.)

The *Morse case* plainly disposes of the taxpayer's contention that the will did not create a valid trust under Section 96 of the New York Real Property Law (*infra*, pp. 39–40), because there was no express power to "receive the rents and profits of real property." Such a power may be implied; and here the necessity to imply the power is plain, because the executors are expressly authorized to "hold and manage" the property (R. 30), and to "pay over the net income thereof" (R. 31). The power to manage and the duty to pay over the net income clearly require the conclusion that the executors had power to receive the rents and profits. Other cases recognizing that the power to receive rents and profits may be implied are *Ogilby* v. *Hickok*, 144 App. Div. 61, affirmed, 202 N. Y. 614; *Hubbard* v. *Housley*, 43 App. Div. 129.

The trust was also valid under Section 96 of the New York Real Property Law (*infra*, pp. 39–40) as a trust to sell land for the benefit of legatees. In *Russell* v. *Hilton*, 80 App. Div. 178, affirmed, 175 N. Y. 525, under circumstances closely similar to the facts in the case at bar, the court said (p. 187):

> The trust in the executors to sell and convert the real estate into money and pay over and distribute the proceeds is a valid express trust to sell land for the benefit of legatees under subdivision 2 of section 55 of the Statute of Uses and Trusts, now section 76 [96] of the Real Property Law. (Laws of 1896, chap. 547.) The executors are not clothed with a mere power in trust, the land itself passing to the heirs; they are expressly authorized until a sale is made "to lease or let the same or any part thereof for such terms as they shall see fit." Thus they are empowered by implication to take the rents and profits until a sale is made. * * *

The taxpayer relies on Section 97 of the New York Real Property Law (*infra*, p. 40), but the New York courts have held that that statute does not apply where a positive direction to sell is accompanied by the right to receive and pay over the rents and profits, or where a discretionary power of sale is subservient to a purpose to have the rents and profits collected and paid over. *Morse* v. *Morse*, 85 N. Y. 53, *supra*; *Lahey* v. *Kortright*, 132 N. Y. 450; *Striker* v. *Daly*, 223 N. Y. 468

The cases cited by the taxpayer seem readily distinguishable. *Henderson* v. *Henderson*, 113 N. Y. 1, follows *Cooke* v. *Platt*, 98 N. Y. 35, in holding that Section 96 of the Real Property Law does not authorize a trust to partition and apportion a residuary estate where the power of sale is not mandatory. Here, the power of sale is mandatory. *Heer-*

*mans* v. *Burt*, 78 N. Y. 259, did not contain any specific direction for the disposition of the rents, and is plainly distinguishable on its facts. The same may be said of *Ray* v. *Fowler*, 200 App. Div. 155. In *Brooklyn Trust Co.* v. *Kernan*, 108 Misc. 452, affirmed, 191 App. Div. 895, the court construed the will as evidencing the testator's desire to transmit the property to the beneficiaries without awaiting the happening of any contingency. But here the intention of the testator that the beneficiaries shall not take the residuary estate *in specie* or at once is plain.

### CONCLUSION

No part of the loss sustained upon the sale of the Commercial Building is deductible in the return of the beneficiary. The decision of the Circuit Court of Appeals allowing a refund should accordingly be reversed.

Respectfully submitted.

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JANUARY, 1933.

# APPENDIX

## STATUTES AND REGULATIONS INVOLVED

### UNITED STATES STATUTES

The Revenue Act of 1916, c. 463, 39 Stat. 756, 757, provided in part as follows:

> SEC. 2. * * *
>
> (b) Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: *Provided*, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.
>
> Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provi-

sions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

The Revenue Act of 1921, c. 136, 42 Stat. 227, 239, 240, 246, provided in part as follows:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only if and to the extent that the profit, if such transaction had resulted in a profit, would be taxable under this title. No deduction shall be allowed under this paragraph for any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities made after the passage of this Act where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed; * * *.

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, whether or not distributed before

the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purposes of the normal tax, be allowed as credits, in addition to the credits

allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be inincluded, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable during the taxable year to such beneficiary.

NEW YORK STATUTES

The New York Real Property Law provides in part as follows:

SEC. 96. *Purposes for which express trusts may be created.* An express trust may be created for one or more of the following purposes:

1. To sell real property for the benefit of creditors;

2. To sell, mortgage or lease real property for the benefit of annuitants or other legatees, or for the purpose of satisfying any charge thereon;

3. To receive the rents and profits of real property, and apply them to the use of any person, during the life of that person, or for any shorter term, subject to the provisions of law relating thereto;

4. To receive the rents and profits of real property, and to accumulate the same for the purposes, and within the limits, prescribed by law.

SEC. 97. *Certain devises to be deemed powers.* A devise of real property to an executor or other trustee, for the purpose of sale or mortgage, where the trustee is not also empowered to receive the rents and profits, shall not vest any estate in him; but the trust shall be valid as a power, and the real property shall descend to the heirs, or pass to the devisees of the testator, subject to the execution of the power.

REGULATIONS

Treasury Regulations 62, promulgated February 15, 1922, under the Revenue Act of 1921, provided in part as follows:

ART. 341. *Estates and trusts.*—While certain estates and trusts are subject to tax as such and others are not, the fiduciary in every case is required to make a return of income. See section 225 of the statute and articles 421–425. The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that in place of the deduction allowed individuals of certain gifts or contributions there may be

deducted, without limitation, from the gross income any part of it which during the taxable year is pursuant to the will or trust deed paid or permanently set aside in the manner specified in section 214 (a) (11). See section 212 and articles 21–26.

ART. 342. *Estates and trusts taxed to fiduciary.*—In the case of (a) estates of decedents before final settlement, (b) trusts, whether created by will or deed, for accumulation of income, whether for unascertained persons or persons with contingent interests or otherwise, and in any other case within section 219 (a) except paragraph 4 thereof, the income is taxed to the fiduciary as to any single individual, except that from the income of a decedent's estate there may first be deducted any amount of income properly paid or credited to a beneficiary. See section 200 of the statute and articles 1521 and 1522. Where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee irrespective of the exercise of the discretion. The imposition of the tax is not affected by the fact that an ultimate beneficiary may be a person exempt from tax. An allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon a sale by the heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived.

ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to

administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income, or may be capital gain, taxable to the estate. See articles 1562 and 1563.

ART. 345. *Estates and trusts taxed to beneficiaries.*—In the case of (a) a trust the income of which is distributable periodically, (b) an ordinary guardianship of a minor, and (c) an estate of a decedent before final settlement as to any income properly paid or credited as such to a beneficiary, the income is taxable directly to the beneficiary or beneficiaries. Each such beneficiary must include in his return his distributive share of the net income, even though not yet paid him, but if his taxable year is different from that of the estate or trust, then he need only include in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within his taxable

year. The regulations governing partnerships are generally applicable to such an estate or trust. See articles 331–335.

ART. 347. *Estates and trusts with income which is distributed periodically, and other income.*—In the case of an estate or trust, the income of which consists both of income to be distributed to beneficiaries periodically and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with section 219 (b) and the tax shall be imposed and paid by the fiduciary in accordance with section 219 (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in section 219 (a) (4) which, pursuant to the will or trust deed, is distributable during its taxable year to the beneficiaries. Each of such beneficiaries shall include, in computing his net income, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to him during the taxable year.

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